SUPREME COURT, U. S.

Supreme Court, U. S.
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IN THE

Supreme Court of the United States

October Term, 1974.

No. 74-251

WILLIAM LEVINSON

and

WILLIAM LEVINSON, Assignee of F.M.P. Corporation, Formerly Known as Fairmount Motor Products Co., Inc.,
Petitioners,

v.

UNITED STATES OF AMERICA.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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THOMAS J. MULLANEY,
JOHN T. CLARY,
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OPINIONS BELOW.

The opinion of the United States District Court for the Eastern District of Pennsylvania is unreported, but a copy is appended at p. A14. The opinion of the United States Court of Appeals, Third Circuit, majority and dissenting opinions, are reported at 496 F. 2d 651 and a copy is appended at p. A2. The opinion in the case of *Papa, et ux. v. Commissioner* which decided the same question as here presented was decided by the United States Court of Appeals, Second Circuit, 464 F. 2d 150 (1972); 72-2 USTC 9516, and is appended at p. A16.

JURISDICTION.

The Judgment of the United States Court of Appeals for the Third Circuit affirming the Judgment of the District Court was entered on May 8, 1974. A timely petition for rehearing was denied on June 11, 1974. A copy of the Judgment of the Third Circuit Court of Appeals is appended at p. A1, and a copy of the Order denying rehearing is appended at p. A13. The jurisdiction of this Court is invoked under 28 USCA 1254(1).

QUESTION PRESENTED FOR REVIEW.

Is the civil tax fraud penalty to be calculated in accordance with the plain language set forth by the United States Congress in the 1954 amendments to the Internal Revenue Code of 1954, 26 USC Sec. 6653(b) and Sec. 6211(a); or is the assessment and calculation to be continued to be made under the formula developed by the court decisions construing the Internal Revenue Code of 1939, 26 USC 1952 Ed., Sec. 293(b) and 271(a)?

STATUTES INVOLVED.

Internal Revenue Code of 1939 (26 U. S. C. 1952 Ed.).

Sec. 271 (as amended by Sec. 14(a). Individual Income Tax Act of 1944, c. 210, 58 Stat. 231). *Definition of Deficiency.*

(a) In General.—As used in this chapter in respect of a tax imposed by this chapter, "deficiency" means the amount by which the tax imposed by this chapter exceeds the excess of—

(1) the sum of (A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus (B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) the amount of rebates, as defined in subsection (b)(2), made.

Sec. 293. *Additions to the Tax in Case of Deficiency.*

(b) Fraud.—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612(d)(2).

Internal Revenue Code of 1954 (26 U. S. C.).

Sec. 6211. *Definition of a Deficiency.*

(a) In General.—For purposes of this title in the case of income, estate, and gift taxes, imposed by subtitles A and B, the term "deficiency" means the amount by which the tax imposed by subtitles A or B exceeds the excess of—

(1) the sum of

(A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

(B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) The amount of rebates, as defined in subsection (b)(2), made.

Sec. 6653. *Failure to Pay Tax.*

(b) Fraud.—If any part of any underpayment (as defined in subsection (c) of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 50 percent of the underpayment. In the case of income taxes and gift taxes, this amount shall be in lieu of any amount determined under subsection (a).

(c) (as amended by Sec. 86, Technical Amendments Act of 1958, P. L. 85-866, 72 Stat. 1606.)—For purposes of this section, the term "underpayment" means—

(1) Income, estate and gift taxes.—In the case of a tax to which section 6211 (relating to income, estate and gift taxes) is applicable, a deficiency as defined in that section (except that, for this purpose, the tax shown on a return referred to in section 6211(a)(1)(A) shall be taken into account only if such return was filed on or before the last day prescribed for the filing of such return, determined with regard to any extension of time for such filing), and

STATEMENT OF THE CASE.

I. History of the Case.

Taxpayers were assessed with civil fraud penalties by the Internal Revenue Service on returns filed for the fiscal years ending January 31, 1957 through January 31, 1962, for F. M. P. Corporation; and the calendar years 1957 through 1961 for the William Levinson. Taxpayers paid the amounts assessed by IRS under protest and thereafter commenced the above captioned lawsuit in the Federal District Court for the recovery of the civil fraud penalties based upon Sec. 1346 of the Judicial Code Act of June 25, 1948, C. 646, 62 Stat. 933, as amended. 28 U. S. C. 1346.

The factual issues in this case were tried before a jury and on June 28, 1973, and upon interrogatories submitted, the jury determined that the civil fraud penalty applied to all original returns filed for the above years.

Prior to trial, the parties, with the approval of the Court, reserved the argument and disposition of the legal issue as to the method of calculating the civil fraud penalties.

On August 29, 1973, Honorable James H. Gorbey, United States District Judge at the trial of this case, issued an Order for a civil judgment in accordance with the jury's verdict in favor of the Defendant, the United States of America, and further issued a Memorandum of Decision pursuant to the aforesaid Stipulation of the parties deciding the legal issue as to the method of calculating the civil fraud penalties. This appeal is from the decision and Order for Judgment of the Third Circuit Court of Appeals affirming, a petition for rehearing having been denied.

II. Factual Circumstances Relating to the Computation of the Fraud Penalty.

1. Tax Returns were timely filed, and taxes for the income shown thereon were timely paid by taxpayers as stated for each of the following periods:

F. M. P. Corporation			*William Levinson*
1/31/57	1/31/58	1/31/59	12/31/57
$69,030.29	$87,672.27	$96,431.39	$36,374.54

2. IRS thereafter conducted routine civil examinations of the above Returns and questioned the treatment of certain items as reported thereon. As a result, IRS issued Revenue Agent Reports assessing additional taxes as stated for each of the following periods, which assessments were agreed to and paid by the taxpayer:

(a) Additional Tax per Revenue Agent Report dated 3/20/59:

F. M. P. Corporation	
1/31/57	1/31/58
$211,473.76	$3,251.63

(b) Additional Tax per Revenue Agent Report dated 6/22/60:

F. M. P. Corporation
1/31/59
$31,684.23

(c) Additional tax paid in accordance with Revenue Agent Report dated 9/18/59:

William Levinson
12/31/57
$16,916.37

3. In July, 1972, taxpayers filed amended returns for each of the stated periods reporting income which had not been included in the original return referred to in paragraph "1" above, nor included in the Revenue Agents Reports referred to in paragraph "2" above. The IRS determined that this unreported income, and certain other income discovered upon a criminal investigation to have been unreported as well as certain other items, *none of which had any connection with the adjustments pursuant to Revenue Agent Reports in paragraph "2" above,* was due to fraud. The IRS made a final determination of the tax due, which has been fully paid by the taxpayers as stated for each of the following periods:

F. M. P. Corporation			*William Levinson*
1/31/57	1/31/58	1/31/59	12/31/57
$288,690.79	$153,363.07	$211,815.84	$144,182.64

4. IRS determined the final tax liability and assessed fraud penalties calculated by subtracting the tax shown on the original returns from the tax as finally determined. Taxpayers have paid the penalties as stated for each of the following periods:

F. M. P. Corporation			*William Levinson*
1/31/57	1/31/58	1/31/59	12/31/57
$110,830.25	$32,845.40	$57,692.23	$41,680.32

5. Taxpayers have paid interest on the above penalties as stated for each of the following periods:

F. M. P. Corporation			*William Levinson*
1/31/57	1/31/58	1/31/59	12/31/57
$4,737.36	$72.16	$703.13	$458.00

REASONS FOR GRANTING THE WRIT.

The United States Court of Appeals for the Third Circuit has decided an important question of federal law in a majority decision by two Justices (App. p. A3) with a dissenting opinion by one Justice (App. p. A9) which should be settled by the U. S. Supreme Court. The particular sections of the Internal Revenue Code as amended 1954 which are here questioned, did not receive any judicial construction until the year 1972. At that time, the Second Circuit Court of Appeals decided the case of *Papa, et ux. v. Comm.*, 464 F. 2d 150, reversing the Tax Court decision, 29 TCM 421, CCH Dec. 30,067(m).

It is important to note that the appeal from the tax court decision involved a small sum of money and the Internal Revenue Service views were presented ex parte, and not contested by the taxpayer. It is undoubtedly for this reason that the Court failed to observe that Congress had made effective and important changes in the 1954 amendments to the Internal Revenue Code. The Court, in the erroneous belief that no changes had been made to the Internal Revenue Code of 1939, applied the decisional law construing the 1939 Code.

The basic difference is that the 1939 Code contained a gaping loophole. The definition of deficiencies contained in Sec. 271(a) provided a formula by which the tax as finally determined supplied the base. From this base, the deficiency was determined by subtracting not only the amount shown on the original Returns, but also any amounts previously assessed as a deficiency. Thus, the fraudulent taxpayer who learned of the tax investigation would quickly file an amended Return, pay the tax, and thus avoid the penalty.

The Courts construing the 1939 Internal Revenue Code (*e.g. Romm v. Comm.*, 245 F. 2d 730 (CA 4, 1957); *Middle-*

ton v. Comm., 200 F. 2d 94 (CA 5, 1952); *Still v. Comm.*, 19 TC 1072 (1953), affirmed per curiam 218 F. 2d 639 (CA 2, 1955)) therefore felt constrained to not follow the formula as written in Sec. 271(a). This result was achieved by the Courts on the rationale that Sec. 293(b) imposing the fraud penalty did not require the literal use of that formula, and the internal language of Sec. 293(b) was susceptible of an interpretation which precluded the fraudulent taxpayer from "dumping" additional tax by the amended return technique.

The legislative history of the Internal Revenue Code of 1954 records the fact that Congress intended to carry forward the decisional law under the 1939 Code. H. Rep. No. 1337, 83d Cong., 2d Sess., p. A419, 3 USC Cong. & Adm. News (1954) 4017, 4567); S. Rep. No. 1622, 83d Cong. 2d Sess. p. 591, 3 USC Cong. & Adm. News (1954) 4621, 5241.

Congress efficiently and effectively carried forward the policies set forth on these decisions by adding to the fraud section, Sec. 6653(c) and specifically providing therein that the fraud penalty was to be calculated in accordance with the unchanged definition of deficiency in Sec. 6211(a) except that only those tax payments made with a timely filed return would be counted in using the formula.

The formula as set forth in Sec. 6211(a), therefore, requires that the deficiency is to be computed by subtracting from the true tax as finally determined all taxes shown on the original return PLUS all previous assessments. The only previous assessments excluded under the rewritten Internal Revenue Code of 1954 are those resulting from the filing of amended returns.

Applying this formula as carefully articulated by Congress and as set forth by the plain language of Sections

6653(b) and 6211(a) would require the use of the following formula:

> deficiency = correct tax—(tax on the original timely filed return + prior assessments)

The majority opinion in the present case represents an improvement over the *Papa v. Comm.* decision (*supra*) in that it at least recognizes that the literal reading of fraud and deficiencies sections of the 1954 Internal Revenue Code are at a variance from the formula which it permits to be applied in this case. It nevertheless refuses to follow these provisions and reverts to the decisional law under the 1939 Code. The majority reasoning appears to follow the premise that the taxpayer has failed to disclose any decisions under the 1939 Code which applied the literal definition of deficiency, and concludes that since Congress did not intend any changes in the law, it necessarily follows that the Courts should still not apply the literal definition of deficiency.

This premise is fallacious in that the decisions under the 1939 Internal Revenue Code did not apply the formula literally, not because of a desire to give the penalty provisions the maximum effect, but only for the reason that it sought to preclude the use of the loophole which the literal wording of the deficiency section provided.

It is the precise function of the graduated income tax to treat each person according to his circumstances so far as possible. There is no question raised in the present case that the prior assessments were routine adjustments, and free of the taint of fraud. There is no question that the mandated application of the fraud penalty formula of the Internal Revenue Code in Sec. 6211(a) permits the tax-

payer to receive credit for non-fraudulent prior assessments. There is no question that this formula may be applied in cases involving the present circumstances without reopening the loophole which Congress effectively closed in rewriting Sec. 6653(b) of the Internal Revenue Code.

The majority decision points out that the taxpayer has not cited any decision under the 1939 Internal Revenue Code which deviated from its construction of the fraud penalty computation. However, the majority decision might equally point out that the Internal Revenue Service is unable to cite any decision where the Courts said that prior assessments which are free from fraud must also be included in computing the fraud penalty. The majority opinion can only be justified if the Congressional intent was to maximize the impact of the penalty to the fullest possible extent, yet that was never the announced policy in the legislative history, nor in the prior decisional law which it brings forward.

Each Court decision which construes the Internal Revenue Code will necessarily have a broad effect. However, the present Court decision will have the effect of allowing the government to impose a penalty on taxpayers not only in the residual area of any part of any underpayment which is due to fraud, but also in those underpayments which the Internal Revenue Service expressly declares to be free of fraud.

CONCLUSION.

For the reasons set forth above, and for the reasons set forth in the Dissenting Opinion in the Third Circuit Court of Appeals (App. pp. A9-A12), this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

JOSEPH B. QUINN,
THOMAS J. MULLANEY,
JOHN T. CLEARY,
ANDREW F. MIMNAUGH,
Attorneys for Petitioner.

Appendix.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT.

No. 73-1909.

WILLIAM LEVINSON AND WILLIAM LEVINSON, ASSIGNEE OF F. M. P. CORPORATION, FORMERLY KNOWN AS FAIRMOUNT MOTOR PRODUCTS CO., INC.,

Appellants,

v.

UNITED STATES OF AMERICA.

(D. C. Civil Action No. 70-1324)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

Present: HUNTER, WEIS, *Circuit Judges* and MILLER, *District Judge.*

JUDGMENT.

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed August 29, 1973, be, and the same is hereby affirmed. Costs taxed against appellants.

ATTEST:

THOMAS F. QUINN,
Clerk.

May 8, 1974.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 73-1909

WILLIAM LEVINSON and WILLIAM LEVINSON,
Assignee of F. M. P. Corporation, Formerly Known as Fairmount Motor Products Co., Inc.,
Appellants,

v.

UNITED STATES OF AMERICA,
Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued February 25, 1974
Before HUNTER and WEIS, *Circuit Judges* and MILLER, *District Judge*

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OPINION OF THE COURT

(Filed May 8, 1974)

HUNTER, *Circuit Judge:*

The sole issue on this appeal is the determination of the proper method by which civil tax fraud penalties are to be assessed under 26 U. S. C. § 6653. The Internal Revenue Service ("IRS") assessed a 50% fraud penalty on the difference between taxpayers' true tax liability and the tax liability shown on taxpayers' original tax returns. The district court upheld this method of computation and we affirm.

Taxpayers' returns for 1957 through 1959 were timely filed and the taxes shown thereon timely paid. When the IRS subsequently conducted routine examinations of these returns, adjustments were made resulting in the assessment of additional taxes. Subsequent to this, taxpayers filed amended returns reporting income which had not been included in the original tax returns. The IRS then began an investigation which uncovered further unreported income of taxpayers and which eventually resulted in the bringing of fraud charges against taxpayers. On this appeal taxpayers do not contest their tax liability or the finding of fraud.

Taxpayers do contend, however, that the fraud penalty should not be applied to those deficiencies assessed because of adjustments made to the original tax return at the time routine audits were conducted. The additional taxes assessed at this time resulted from adjustments to inventories and business deductions. These adjustments apparently were not the subject of the subsequent fraud investigation which was based on omitted income. Thus

the taxpayers suggest that the fraud penalty should have been computed by the following formula:

> 50% x [correct tax—(tax shown on original timely filed return + additional tax assessed because of routine audit on original return)]

The fraud penalty was actually computed on the basis of this formula:

> 50% x [correct tax—tax shown on original timely filed return]

Taxpayers argue that the decisional law and applicable statute supports their view that the fraud penalty should not apply to nonfraudulent deficiencies assessed as a result of routine adjustments made to their original returns. We do not agree.

Under the Internal Revenue Code of 1939, the fraud penalty provision, section 293(b), provided that "if *any part* of any deficiency is *due to fraud* . . . then 50 per centum of the *total amount of the deficiency* . . . shall be assessed . . . ." (Emphasis added.) "Deficiency" was defined under section 271(a) by the following formula:

> deficiency = correct tax—(tax shown on return + amounts previously assessed or collected without assessment—rebates)[1]

Where there have been several deficiencies, this definition quite logically requires that, in computing the amount of any new deficiency, credit should be given for deficiencies previously assessed or collected.

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1. *See Kurtzon v. Commissioner*, 17 T. C. 1542, 1548 (1952); Rev. Rul. 60-214, 1960-1 Cum. Bull. 700.

In computing the fraud penalty under the 1939 Code, however, courts consistently refused to apply the penalty to only this narrowly defined deficiency. *E.g., Middleton v. Commissioner,* 200 F. 2d 94 (5th Cir. 1952); *Romm v. Commissioner,* 245 F. 2d 730 (4th Cir.), *cert. denied,* 355 U. S. 862 (1957). Since the fraud penalty provision referred to "the total amount of the deficiency," courts consistently reasoned that where more than one deficiency had been assessed, the penalty applied to all of the deficiencies;[2] thus, the total deficiency was held to be the difference between the correct tax and the tax shown on the original return. *Romm v. Commissioner, supra; Middleton v. Commissioner, supra; Still, Inc. v. Commissioner,* 19 T. C. 1072 (1953); *Wilson v. Commissioner,* 7 T. C. 395 (1946); *J. S. McDonnell v. Commissioner,* 6 B. T. A. 685 (1927).

Contrary to what taxpayers suggest, we have found no decision under the 1939 code which deviated from this method of computing the fraud penalty or even suggested that in certain situations a different method of computation would apply. Taxpayers rely heavily on *J. S. McDonnell v. Commissioner,* 6 B. T. A. 685 (1927) as support for the proposition that in computing the fraud penalty the IRS should allow taxpayers "legitimate adjustments" to the tax as reported on the original return.[3]

Taxpayers, however, have misread *McDonnell.* The 50% fraud penalty in that case was applied to the difference between the correct tax and the tax shown on the

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2. The effect of this was to refuse to follow the literal definition of deficiency (which would require that credit be given for previously assessed deficiencies) whenever the fraud penalty was imposed. *See, e.g., Romm v. Commissioner, supra.*

3. Brief of Appellants at 9.

original return.[4] The court specifically held that no error had been committed in the method of computation of the penalty.[5] What the court did say, which is far different from that contended by the taxpayers, is that in computing the total tax liability and hence the correct deficiency, the IRS had failed to give credit for legitimate deductions and losses. Taxpayers, however, have not contested the final tax liability determined by the IRS and therefore *McDonnell* does not support taxpayers' position. It is also significant that *McDonnell* was specifically cited by the same court in *Wilson v. Commissioner*, 7 T. C. 395, 398 (1942) when it noted that,

> "[S]ince the Revenue Act of 1918, the [IRS] has consistently computed the [fraud] penalty upon the *total amount understated on the return* and in every instance in those cases coming before us of which we are aware, we have approved the computation." (Emphasis added.)

We therefore conclude that under the Internal Revenue Code of 1939, it was the court-sanctioned practice of the IRS to compute fraud penalties on the difference between the correct tax and the tax shown on the original return. The only question remaining then is whether the enactment of the Internal Revenue Code of 1954 affected changes in this substantive policy. We think not.

The present fraud penalty provision, 26 U. S. C. § 6653(b), differs from its predecessor only in its use of the word "underpayment" rather than deficiency:

> "If *any part* of any underpayment . . . of tax required to be shown on a return *is due to fraud*, there

4. 6 B. T. A. at 690-91. See *Wilson v. Commissioner*, 7 T. C. 395, 398 (1946), wherein the same court explained that in *McDonnell* it had "held that the penalty was to be computed upon the entire excess of the tax liability over that shown on the return."

5. 6 B. T. A. at 695.

shall be added to the tax an amount equal to 50 percent of the underpayment." (Emphasis added.)

"Underpayment" is defined in section 6653(c)[5] by reference to the definition of deficiency in 26 U. S. C. § 6211[6] which is virtually identical to its predecessor, section 271(a). Section 6653(c), however, states that for purposes of defining deficiency, only the tax shown on the original timely filed return is to be considered.

On their face these changes appear minor and at most appear to merely clarify what the practice had been under the 1939 Code. That this was the Congressional intent is

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5. 26 U. S. C. § 6653(c) provides, *inter alia:*

"For purposes of this section, the term 'underpayment' means—

"(1) *Income, estate, and gift taxes.*—In the case of a tax to which section 6211 (relating to income, estate, and gift taxes) is applicable, a deficiency as defined in that section (except that, for this purpose, the tax shown on a return referred to in section 6211(a)(1)(A) shall be taken into account only if such return was filed on or before the last day prescribed for the filing of such return, determined with regard to any extension of time for such filing) . . . ."

6. 26 U. S. C. § 6211 provides, *inter alia:*

"*Definition of a deficiency*

"(a) *In general.*—For purposes of this title in the case of income, estate, and gift taxes, imposed by subtitles A and B, the term 'deficiency' means the amount by which the tax imposed by subtitles A or B exceeds the excess of—

"(1) the sum of

"(A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

"(B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

"(2) the amount of rebates, as defined in subsection (b)(2), made."

unquestionably clear from the legislative history.[7] We thus agree with the Second Circuit that the Internal Revenue Code of 1954 did not change the method of computing the fraud penalty and that the method by which the IRS has computed the penalty in the present case is proper under 26 U. S. C. § 6653. *See Papa v. Commissioner*, 464 F. 2d 150 (2nd Cir. 1972).

In view of taxpayers' insistence that deficiencies assessed as a result of the routine audit of their returns must be applied as a credit pursuant to 26 U. S. C. § 6211(a)(1)(B), a few further observations appear necessary. First, section 6211(a)(1)(B) is identical to its predecessor under the 1939 Code, section 271(a)(1)(B), and as noted previously, prior deficiencies were never applied under the 1939 Code as a credit in determining the "total" deficiency subject to the fraud penalty.

Second, taxpayers suggest that previously assessed deficiencies should be applied as credit under section 6211(a)(1)(B) *just in some circumstances*.[8] Yet, there is no support in the statute, its legislative history or in the case law for applying section 6211(a)(1)(B) selectively.

Third, the inequities of taxpayers' position is manifest. Had there been only one deficiency assessed coupled with a finding that at least a part of the underpayment was due to fraud, then there would not have been any previously assessed deficiency for which taxpayers could claim a credit under section 6211(a)(1)(B). The fraud penalty quite clearly would have been applied to the total underpayment, *i.e.*, the difference between the correct tax and the

7. For a discussion of the legislative history see *Papa v. Commissioner*, 464 F. 2d 150, 152 (2nd Cir. 1972).

8. Taxpayers apparently argue that section 6211(a)(1)(B) should be applied just to those deficiencies assessed because of "legitimate adjustments" made to their original timely filed returns as a result of a routine audit. Presumably, they would add that this previously assessed deficiency was not due to fraud.

tax shown on the original timely filed return. It does not seem likely that Congress would have conditioned the severity of the fraud penalty on such a fortuity as whether or not a routine audit had been conducted prior to the assessment giving rise to the fraud charge.

Lastly, if there is ambiguity in the statutory language, we think the clear Congressional purpose must prevail.[9] Since Congress unquestionably did not intend to modify the substantive law under the 1939 Code, we agree with the Second Circuit that the fraud penalty under 26 U. S. C. § 6653 is properly computed on the basis of the difference between the correct tax and the tax shown on the original timely filed return. *Accord, Papa v. Commissioner,* 464 F. 2d 150 (2nd Cir. 1972).

The order of the district court of August 29, 1973 will be affirmed.

WEIS, *Circuit Judge,* dissenting:

The dreary pages of the Internal Revenue Code contain few passages of any comfort to the taxpayer. The petitioner here has found several provisions which, when read literally and given their common sense meaning, support his position and bring about an equitable result. It is only by reliance upon previous judicial interpretations, written in response to a need which no longer exists, that the Commissioner is able to prevail, thus increasing the government's revenue but diminishing the resources of the taxpayer. Since I believe that the plain wording of the statute should prevail, I must dissent.

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9. *See, e.g., United States v. American Trucking,* 310 U. S. 534, 543-49 (1940).

As the majority concedes, the fraud penalty is computed on the "underpayment,"[1] which term is defined as a "deficiency,"[2] which means the amount by which the correct tax exceeds the sum of (a) the amount shown on the taxpayer's return plus (b) amounts previously assessed.[3]

I agree with the majority's statement of the formula:

deficiency = correct tax — (tax shown on return + amounts previously assessed).

Applying the statute literally means that the taxpayer here should pay the penalty of 50 percent only on the amount of tax due because of fraud and not on that portion of the tax which had been paid as a result of a previous assessment based on adjustments for items as to which there was a legitimate basis for difference of opinion. This result is sound and would appear to be eminently reasonable.

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1. Section 6653(b) of the Internal Revenue Code of 1954:

"If any part of any underpayment . . . of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 50 percent of the underpayment."

2. Section 6653(c) of the Internal Revenue Code of 1954.

3. Section 6211 of the Internal Revenue Code of 1954:

"Definition of a deficiency

(a) In general.—For purposes of this title in the case of income, estate, and gift taxes, imposed by subtitles A and B, the term 'deficiency' means the amount by which the tax imposed by subtitles A or B exceeds the excess of—

(1) the sum of

(A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

(B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) the amount of rebates, as defined in subsection (b)(2), made."

The difficulty is that years ago in construing earlier versions of the Internal Revenue Code, the Tax Court found a "loophole" which it felt obliged to close. The problem was articulated in *Still v. Commissioner*, 19 T. C. 1072, *aff'd*, 218 F. 2d 639 (2d Cir. 1959), where the court said at 1077:

> "A taxpayer who had filed a fraudulent return would merely take his chances that the fraud would not be investigated or discovered, and then, if an investigation were made, would simply pay the tax which he owed anyhow and thereby nullify the fraud penalty."

This rationale was adopted by the Courts of Appeal in *Middleton v. Commissioner*, 200 F. 2d 94 (5th Cir. 1952), and *Romm v. Commissioner*, 245 F. 2d 730 (4th Cir. 1957), *cert. denied*, 355 U. S. 862 (1957). These cases involve tax assessments prior to the enactment of the 1954 Code, and in each one all of the deficiencies were based on fraud. While there might be some argument about the court's power to ignore the wording of the statute, nevertheless the equities favor the result.

The "loophole" about which the courts were concerned was closed through congressional action in 1954 by including in section 6653(c) a provision that the "amount shown on a taxpayer's return" means a return which is timely filed. Thus, a taxpayer who learns that his tax liability is being questioned and who files a later amended return can secure no reduction of the amount of the penalty due by such action. The calculation of the fraud penalty after 1954 clearly involves only the original return, not an amended one. Therefore, the opportunity to "make sport of the so-called fraud penalty" which concerned the *Still, supra*, and *Romm, supra*, courts is no longer available.

Papa v. Commissioner, 464 F. 2d 150 (2d Cir. 1972), failed to note the pertinent change in the 1954 Code and, adopting the reasoning of the older cases,[4] refused to allow credit for an earlier assessment made by the Internal Revenue Service. However, *Papa, supra,* was in the nature of an ex parte proceeding, the appeal having been taken by the Commissioner and not contested by the taxpayer. Furthermore, the earlier deficiency which the court refused to credit was also fraudulent. Equities, therefore, favor the result in *Papa, supra,* as they did in the earlier cases.

Here, however, fundamental fairness supports the taxpayer's position, and there would seem to be no reason why we should apply decisional law today which was originally developed to remedy a statutory infirmity since cured by legislative revision.

The majority finds fault with petitioner's contention that a deficiency under section 6211(a)(1)(B) should be credited only in circumstances of nonfraudulent assessments, and dismisses the taxpayer's position by saying that there is no support in the statute for such an interpretation. We need not reach that point in this case, although to my mind the taxpayer's interpretation is far preferable to the one which the courts have made over the years by completely disregarding credit for all prior assessments paid despite the plain wording of the statute. The petitioner's suggestion requires only a modest construction to promote equity, while the decisional law involves a major interpretation which furthers inequity.

I would give to the petitioner that which the statute requires and reverse the decision of the district court.

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4. Still, *supra,* Romm, *supra,* and Wilson v. Commissioner, 7 T. C. 395 (1946).

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT.

No. 73-1909.

WILLIAM LEVINSON AND WILLIAM LEVINSON, ASSIGNEE OF F. M. P. CORPORATION, FORMERLY KNOWN AS FAIRMOUNT MOTORS PRODUCTS CO., INC.,

Appellants,

v.

UNITED STATES OF AMERICA,

Appellee.

SUR PETITION FOR REHEARING.

Present: SEITZ, *Chief Judge,* VAN DUSEN, ALDISERT, ADAMS, GIBBONS, ROSENN, HUNTER, WEIS, GARTH, *Circuit Judges,* and MILLER, *District Judge.*

The petition for rehearing filed by Appellants in the above entitled case having been submitted to the judges who participated in the decision of this court and to all other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By THE COURT,

JAMES HUNTER, III,
James Hunter, III,
Judge.

Dated: June 11, 1974.

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

CIVIL ACTION NO. 70-1324.

WILLIAM LEVINSON AND WILLIAM LEVINSON, ASSIGNEE OF F. M. P. CORPORATION, FORMERLY KNOWN AS FAIRMOUNT MOTOR PRODUCTS CO., INC.

v.

UNITED STATES OF AMERICA.

MEMORANDUM OF DECISION.

GORBEY, *J.* August 29, 1973.

This court has been called upon to decide whether the penalty for fraudulent underpayment of income tax [imposed by 26 U. S. C. § 6653(b) and (c)] is imposed upon income which the taxpayer omitted from his original tax return, but for which tax was later paid as a result of an investigation of the Internal Revenue Service which preceded a second investigation by that agency in which fraud was detected for the first time. While the taxpayer has shown that a literal reading of 26 U. S. C. §§ 6653(b), 6653(c) and 6211 would prohibit the imposition of a penalty on such income, this court feels obliged to follow *Papa v. CIR*, 464 F. 2d 150 (2d Cir. 1972) in which the precise issue was determined adversely to the taxpayer.

By THE COURT:

JAMES H. GORBEY,
James H. Gorbey,
U. S. District Judge.

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

CIVIL ACTION NO. 70-1324.

WILLIAM LEVINSON AND WILLIAM LEVINSON, ASSIGNEE OF F. M. P. CORPORATION, FORMERLY KNOWN AS FAIRMOUNT MOTOR PRODUCTS CO., INC.

v.

UNITED STATES OF AMERICA.

CIVIL JUDGMENT.

AND NOW, this 29th day of August, 1973, in accordance with the answers to interrogatories and the jury's verdict, and upon consideration of the briefs by both parties concerning the proper measure of the fraud penalty assessed by the defendant and paid by the plaintiff, for such reasons set forth in the accompanying Memorandum of Decision;

IT IS ORDERED that judgment be and hereby is entered in favor of the defendant, the United States of America, against the plaintiffs, William Levinson and William Levinson, assignee of F. M. P. Corporation, formerly known as Fairmount Motor Products Co., Inc., together with costs.

BY THE COURT:

JAMES H. GORBEY,
James H. Gorbey,
U. S. District Judge.

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

FRANK C. AND MARY PAPA,

Appellees,

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellant.

U. S. Court of Appeals, 2nd Circuit, Docket No. 71-1899, 6/13/72. Modifying Tax Court decision, 29 TCM 421, CCH Dec. 30,067(M).

Scott P. Crampton, Assistant Attorney General, James H. Bozarth, Meyer Rothwacks, Richard W. Perkins, Department of Justice, Washington, D. C. 20530, for appellant.

Before WATERMAN, HAYS and FEINBERG, Circuit Judges.

WATERMAN, Circuit Judge: After the Commissioner of Internal Revenue had determined that there were deficiencies in the taxes reported in taxpayers' returns for the taxable years 1954-1959, taxpayer petitioned the Tax Court for redeterminations of the deficiencies in the returns for 1954-1956, and of the accompanying penalties the Commissioner had assessed. The Commissioner appeals from the decision the Tax Court entered, reported, with opinion, at [CCH Dec. 30,067(M)] 29 T. C. M. 421.

In his appeal the Commissioner, satisfied with most of the Tax Court's disposition of the issues before it, seeks to have us reverse that portion of the Tax Court's decision which does not hold that, for the purposes of assessing

the fraud penalty imposed by Section 6653(b)[1] of the Internal Revenue Code of 1954 (26 U. S. C. § 6653(b)) the Commissioner could include as part of an "underpayment" the amounts assessed against and paid by the taxpayers subsequent to the filing of the taxpayers' original return and payment of tax based thereon, but prior to the issuance of the Commissioner's statutory notice to taxpayers of the deficiency in their tax payments. The Commissioner asserts that, although only $1,153.41 is at stake in his appeal in this case, there are far-reaching ramifications of the Tax Court's decision which "would make sport of the so-called fraud penalty." *George M. Still, Inc. v. Commissioner* [CCH Dec. 19,511], 19 T. C. 1072, 1077 (1953), *aff'd per curiam,* [55-1 USTC ¶ 9172] 218 F. 2d 639 (2 Cir. 1955). We agree with the Commissioner; and, for the reasons set out below, reverse the decision of the Tax Court to the extent discussed in this opinion.

[*Facts*]

The facts of this particular case were, for the most part, agreed to by stipulation, and were adequately dealt with by the Tax Court. The question before us is one of law only and depends for its resolution upon the interpretation of relevant statutes. Thus, we set forth only a brief sketch of the pertinent facts. The appellees, Frank Papa and his wife Mary, filed joint income tax returns for all of the taxable years involved here. Between the years 1954 and 1959, Frank Papa was the sole proprietor

1. 26 U. S. C. § 6653(b) in pertinent part reads as follows:
§ 6653. Failure to pay tax

* * *

(b) Fraud.—If any part of any underpayment (as defined in subsection (c)) of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 50 percent of the underpayment. . . .

of the Brighton Blacktop Paving Company. After an audit of that company's financial records in 1956, the Commissioner concluded that the taxpayer had understated his business receipts for the years 1954 and 1955. Accordingly, a deficiency in the amount of $2,306.83 for the year 1954[2] was calculated and assessed, and the appellee paid this assessed deficiency on November 23, 1956. In 1958, after a routine audit of the appellees' 1956 return, a deficiency was again assessed. In 1960, when yet another audit, this one for the years 1957-1959, revealed numerous inaccuracies and discrepancies, the matter was referred to the Intelligence Division for possible fraud investigation. The ensuing investigation resulted in the issuance on September 17, 1963 of a notice of deficiency for the years 1954-1956 and the issuance of a similar notice on August 17, 1962 for the years 1957-1959. For the year relevant to this appeal, 1954, the Commissioner determined that, in addition to the deficiency of $2,306.83 mentioned above which had already been assessed and paid in 1956, the appellees had underpaid their taxes for that year by $12,338.98. It was concluded that the total underpayment was due to fraud and, pursuant to Section 6653(b), there was added to the tax determined to have been underpaid for that year an amount equal to 50% of the total underpayment of $14,645.81, viz., $7,322.90. Taxpayers challenged that determination of the Tax Court.

The Tax Court agreed with the Commissioner that $12,338.98 of the total 1954 underpayment was indeed due to fraud, but it held that the deficiency of $2,306.83 which had been assessed and paid in 1956 could not, within the relevant portions of the Code, be considered an "underpayment" for the purposes of the fraud penalty contained

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2. Because a loss had been reported by the taxpayer for the year 1955, the unreported business receipts did not result in the determination of a deficiency for that year.

in Section 6653(b). That holding was based upon the determination that "[u]nder Section 6211(a)(1)(B), the amounts previously assessed shall be added to the amount shown as the tax on a taxpayer's return for purposes of determining the amount of the deficiency."[3] The Commissioner maintains that such an interpretation of Sections 6653 and 6211 disregards the clearly expressed Congressional intent to carry forward the law existing under the Internal Revenue Code of 1939 (26 U. S. C. A. (I. R. C. 1939)) relating to the fraudulent underpayment of taxes. We agree with the Commissioner.

[*Prior Law*]

Under the 1939 Code, Section 293(b) imposed a penalty of "50 per centum of the total amount of the deficiency" due to fraud. The term "deficiency" was defined by Section 271(a) as set forth in the margin.[4] Those sections

3. Section 6211(a) (26 U. S. C. § 6211(a)) which was interpreted by the Tax Court reads as follows:

§ 6211. Definition of a deficiency

(a) In general.—For purposes of this title in the case of income, estate, gift, and excise taxes, imposed by subtitles A and B, and chapter 42, the term "deficiency" means the amount by which the tax imposed by subtitle A or B or chapter 42 exceeds the excess of—

(1) the sum of

(A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

(B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) the amount of rebates, as defined in subsection (b)(2), made.

4. Section 271(a) of the 1939 Code reads as follows:

§ 271. Definition of deficiency

(a) In general. As used in this chapter in respect of a tax imposed by this chapter, "deficiency" means the amount by which the tax imposed by this chapter exceeds the excess of—

were uniformly construed by the courts to impose the penalty upon the "difference between the tax liability and the amount shown on the taxpayer's return . . . ." *Wilson v. Commissioner* [CCH Dec. 15,287], 7 T. C. 395, 397 (1946). It was immaterial whether the total deficiency assessed after discovery of that difference was determined in one assessment or in several assessments. *Wilson, supra* at 399. In *Romm v. Commissioner* [57-2 USTC ¶ 9757], 245 F. 2d 730 (4 Cir.), *cert. denied,* 355 U. S. 862 (1957), the court dealt with a similar problem, that of the impact of the fraud penalty upon a taxpayer who has made a voluntary payment of taxes after investigation of the taxpayer's income had commenced. The court stated there:

> Taxpayer contends that the "deficiency" upon which the fraud penalty is levied by Section 293(b) is determined by the definition of "deficiency" contained in Section 271(a), 26 U. S. C. A. § 271(a). In general terms, the definition of Section 271(a) is that a deficiency is the amount by which the total tax liability exceeds the total of all amounts previously paid. We do not think that the word "deficiency" in Section 293(b) was meant to be so restricted. We agree with the Commissioner that it means the original deficiency in its entirety, as was held in *Middleton v. Commissioner of Internal Revenue,* 5 Cir. [52-2 USTC ¶ 9549] 200 F. 2d 94.

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4. (Cont'd.)

(1) the sum of (A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus (B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) the amount of rebates, as defined in subsection (b)(2), made.

[*No Change Initiated in 1954*]

Whether Congress intended to disturb the existing law in this particular when it passed the Internal Revenue Act of 1954 appears never to have been decided by a Court of Appeals, perhaps because it seems obvious that the statutory history indicates that Congress did not intend to affect the existing interpretation. Sections 293(b) and 271(a) of the 1939 Code were recodified as Sections 6653(b) and 6211(a), respectively, of the new 1954 Code. There are only minor textual differences between the corresponding sections,[5] and the relevant Congressional Reports indicate plainly that no substantive change in the law relating to the fraud penalty was intended. We quote the relevant Committee Reports: "For all taxes for which returns are required, this section [6653(b)] prescribes additions to the tax, corresponding to those of existing law relating to the income tax, for underpayments of tax resulting from fraud (50 percent of the underpayment)." S. Rep. No. 1622, 83d Cong., 2d Sess., p. 591 (3 U. S. C. Cong. & Adm. News (1954) 4621, 5241); H. Rep. No. 1337, 83d Cong., 2d Sess., p. A. 419 (3 U. S. C. Cong. & Adm. News (1954) 4017, 4567). It is stated in each report that Congress was making no material change from existing law through the enactment of the Section 6211 definition of a deficiency. See S. Rep. No. 1622, *supra*, 3 U. S. C. Cong. & Adm. News (1954) at 5222; H. Rep. No. 1337, *supra*, 3 U. S. C. Cong. & Adm. News (1954) at 4552.

Moreover, and most importantly, the Tax Court's interpretation of the interplay of Section 6211(a)(1)(B) with Section 6633(b) would "nullify the fraud penalty" for, as pointed out in *George M. Sill, Inc. v. Commissioner*,

5. A comparison of the new sections with the old reveals only a minor change in terminology. While Section 293(b) of the 1939 Code used the language "total amount of the deficiency," Section 6653, I. R. C. 1954, uses the term "underpayment."

supra, 19 T. C. at 1077: "A taxpayer who had filed a fraudulent return would merely take his chances that the fraud would not be investigated or discovered, and then, if an investigation were made, would simply pay the tax which he owed anyhow and therefore nullify the fraud penalty." It is highly unlikely that Congress would have intended the result so favorable to tax evaders which the Tax Court reached here.

We order that the Tax Court decision is to be modified in accordance with this opinion.